

State Update: Western Australia – September 2015



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Key points

- **While a surge in mineral production and exports from newly completed projects will contribute to Western Australia's GSP growth, the fall in employment and a lack of offsetting non-mining business and dwelling investment means domestic demand will remain very weak.** The falls in iron ore prices will continue to put a material dent into the state government's coffers, limiting scope for more expansionary fiscal policy. **Consequently, we expect GSP growth in WA to continue its slowdown from rates over 5% in past years (on average), to below 2% in 2015-16. A ramping-up in LNG exports in subsequent years should see growth lift to 3¼% (Chart 1).** Correspondingly, the unemployment rate is expected to peak at a little over 6¼% next year before gradually starting to improve.
- The final phase of the once-in-a-generation mining boom is being felt right across the WA economy. State final demand has fallen significantly (Chart 2), and strong growth in commodity export volumes has only partially offset the large hit to incomes coming from significantly lower commodity (namely iron ore) prices.
- The winding down of mining investment projects has driven a decline in WA business investment, which fell almost 10% over the year to Q2 2015. **A significant depletion in the mining investment pipeline suggests further falls in investment are on the way. In addition, declines in iron ore prices have seen mining revenues decline despite an increase in production and export volumes.** This then has implications for government revenues, worsening the states fiscal position – the latest budget included \$10.2 billion in revenue write-downs due to the softer economy and commodity price declines.
- In addition to the direct impacts on mining revenue and investment, spill over effects are clearly evident in the broader WA economy. **Wages have come under significant pressure and population growth has slowed considerably** – primarily due to lower overseas migration, although interstate migration has also ground to a halt. **These trends have resulted in much more subdued growth in consumption and considerable declines in residential property prices in some markets.**
- Naturally, the winding down of mining investment has exerted significant downward pressure on the labour market, which has been only partly mitigated by declines in population growth. The trend unemployment rate for WA has risen steadily to 6%, up from a pre-GFC low of around 3.7%, and above the GFC high of 5.4%. That said, lost jobs in the mining industry have to date been more than offset by increases in more labour intensive industries such as health and business services.
- **Outside of the mining sectors, some of the business and investment indicators appear to be somewhat mixed.** Business conditions and confidence from the NAB Business Survey are particularly weak for WA and while this is most apparent in the mining related segments of the economy, confidence was negative for all industries in Q2 2015. Nevertheless, capacity utilisation has been relatively steady, while both NAB and ABS measures on non-mining business intentions have generally held up – although levels of non-mining investment in WA pales in comparison to declines in mining investment.

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Chart 1: State GSP Growth Forecasts

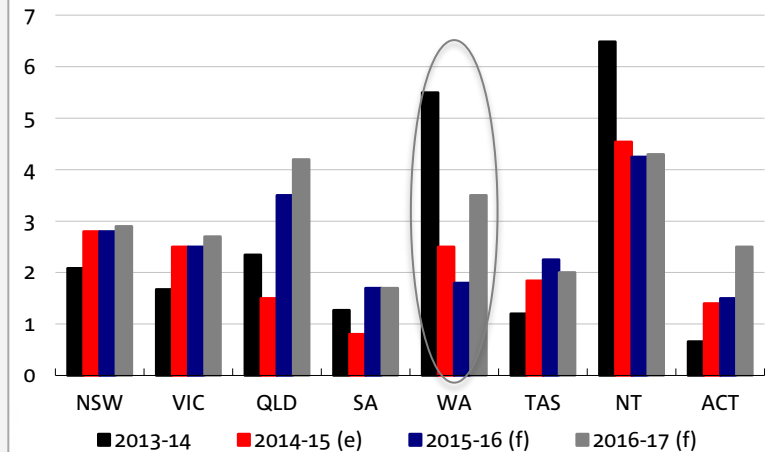
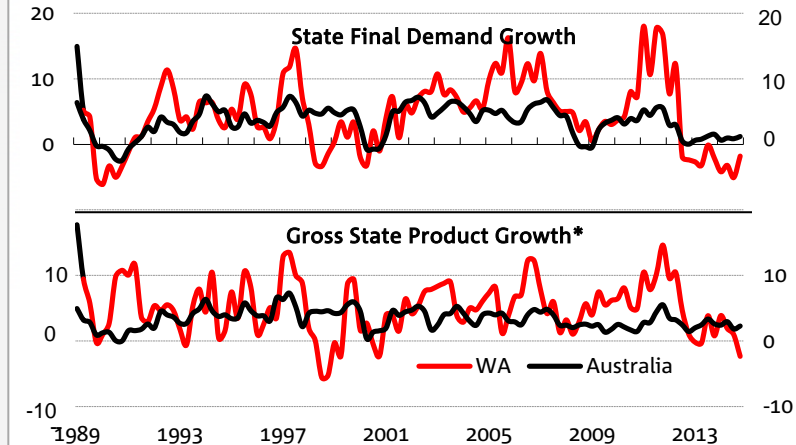


Chart 2: State Growth



* NAB estimate

Sources: ABS; NAB Economics



In Focus: Economic impacts from falling commodity prices

Dramatic declines in iron ore prices and a winding down of large mining investment projects is having (and will continue to have) a dramatic impact on the WA economy. The fall in iron ore prices from around USD 120 per tonne to around USD 50 per tonne (Chart 3) has wiped out more than \$70 billion dollars of potential annual revenue from Australian exports (the vast majority from WA). This also has flow-on effects to other industries as well as government revenues – WA Budget sensitivity analysis suggests that iron ore royalties fall by \$70 million for every USD1 decline in the ore price.

State domestic final demand has already been hit hard by falling investment, and with the pipeline of projects depleting quickly, there is potential for more significant declines to come (Chart 4).

The impact on the labour market and wages is taking a toll on population growth and residential property markets (especially those regions closely connected to mining operations (Charts 5 & 6).

Chart 3: Iron ore spot and contract prices (US\$/t)

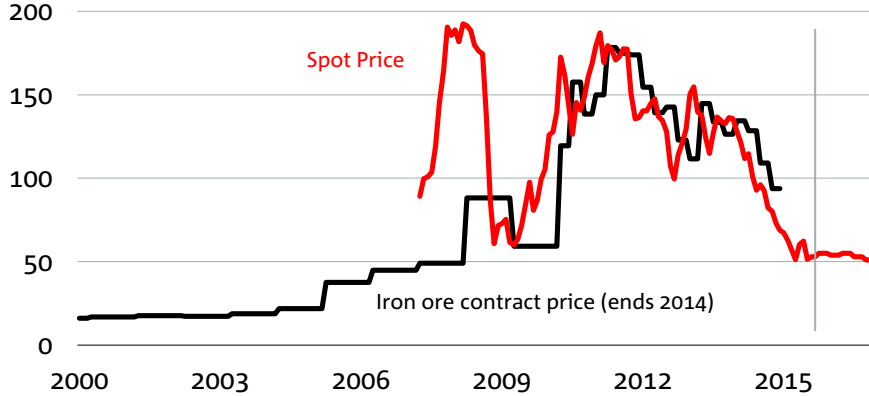


Chart 4: Engineering work yet to be done, heavy industry, WA (\$bn)

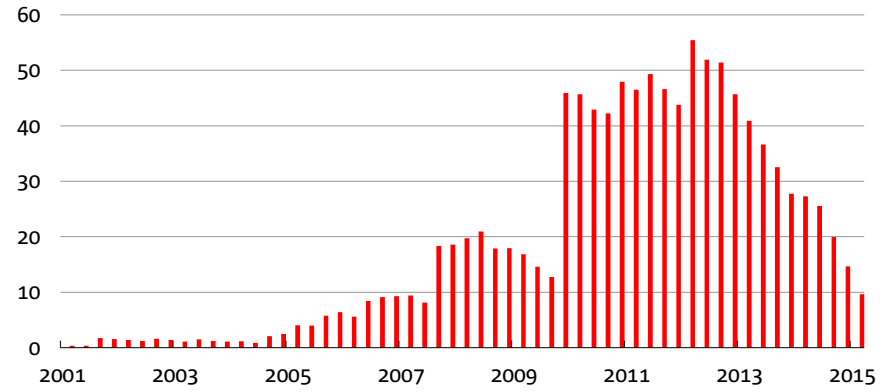


Chart 5: Population growth, WA, 000s, over the year

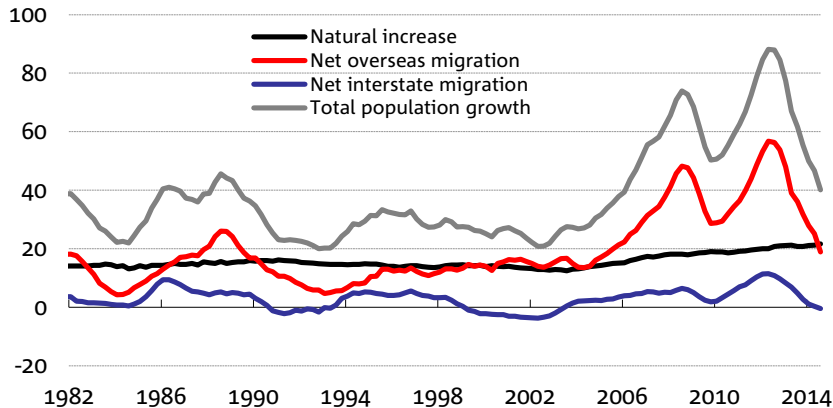
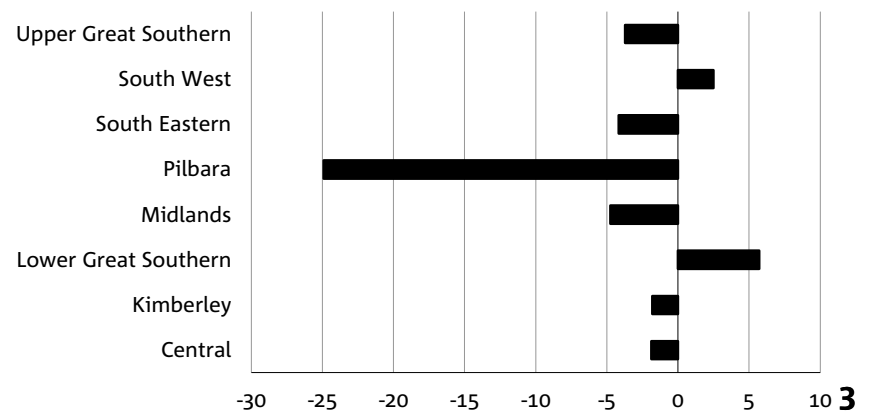


Chart 6: Regional WA - Median House Price Growth (year to Q1 2015)



Source: ABS; BREE; Bloomberg; CoreLogic; NAB Economics



Falling incomes and house prices weighing on consumers

Labour income growth in WA has been extremely weak, reflecting a steady deterioration of the labour market as major mining and infrastructure projects are completed. After running well ahead in recent years, mining wages growth has now fallen below growth in the national wage price index. Naturally, this has had a dampening effect on consumer spending (Chart 7) .

Unlike the major eastern states, WA is not enjoying positive wealth effects from higher property prices (Chart 9).

On a more positive note, the NAB Consumer Anxiety Survey suggested that consumer anxiety eased slightly in Q3 2015 – although the index remains relatively elevated.

Despite this, households did not show any greater inclination to spend on non-discretionary items than they did the previous quarter. The main focus of spending behaviour continues to be very much concentrated on essential items – such as utilities and medical expenses (Chart 8).

Chart 7: Average Compensation and Household Consumption Growth (YoY)

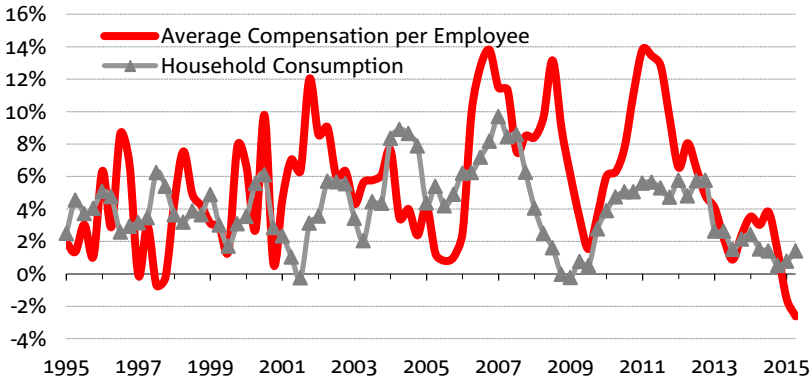


Chart 9: WA Retail sales & house price growth

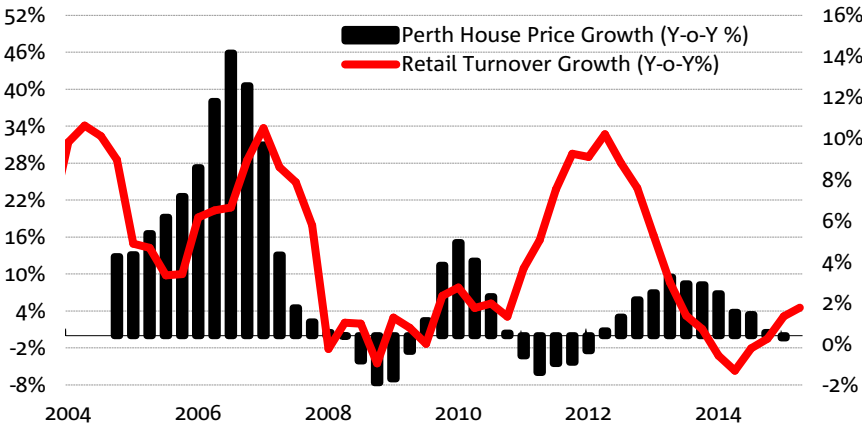
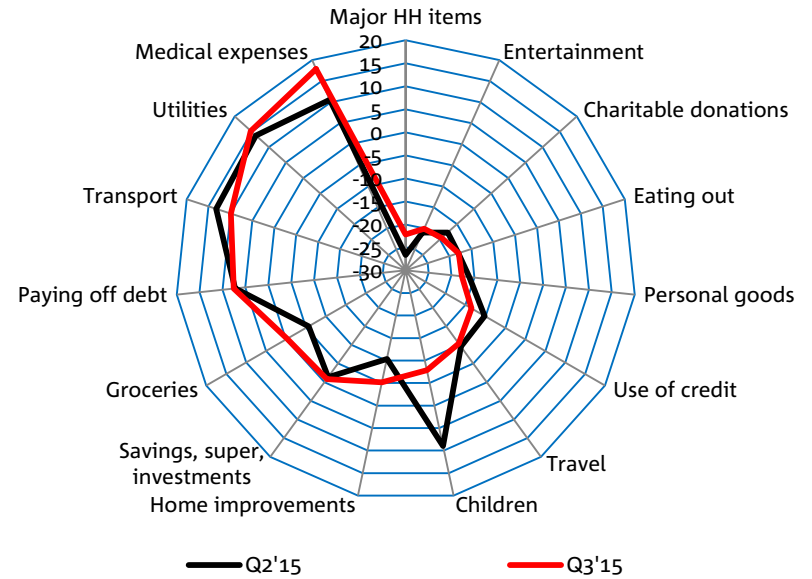


Chart 8: Changes in Spending Behaviours by State: WA





Mining sector a significant drag on WA business environment

According to the monthly NAB Business Survey, capacity utilisation of businesses in WA has been surprisingly steady, although it is below the national average and well down on previous peaks (Chart 10). Subdued levels of capacity utilisation are consistent with soft business conditions in the state (Chart 11).

The NAB Survey is weighted towards the non-mining industries. Conditions in the mining industry are significantly weaker than the state aggregate suggests.

Given the non-mining emphasis, investment expectations from the NAB Survey have been much more robust than actual investment outcomes. In contrast, ABS capex expectations suggest further declines (slide 6, Chart 12).

Recreational & personal services are showing the best business conditions in the NAB Survey, with construction also holding up as surprisingly well (likely due to residential activity). However, the downturn in commodity markets (and its implications for the local mining industry) is negatively affecting confidence across all sectors (Chart 13).

Chart 10: NAB Business Survey – Capacity Utilisation (%)

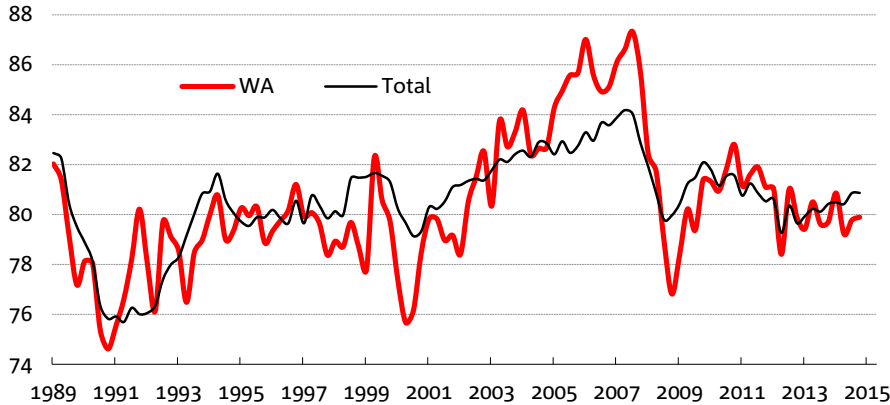
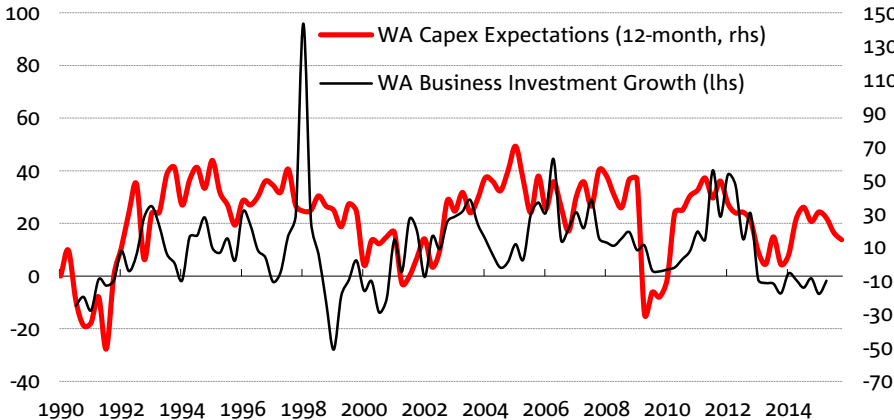


Chart 12: NAB Survey Capex Expectations & Private Business Investment Growth



Sources: ABS; NAB Economics

Chart 11: Spread in NAB Business Conditions (net balance)

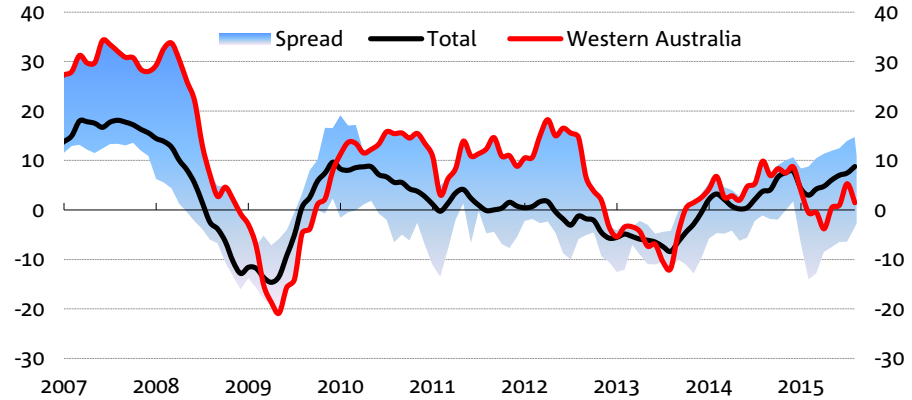
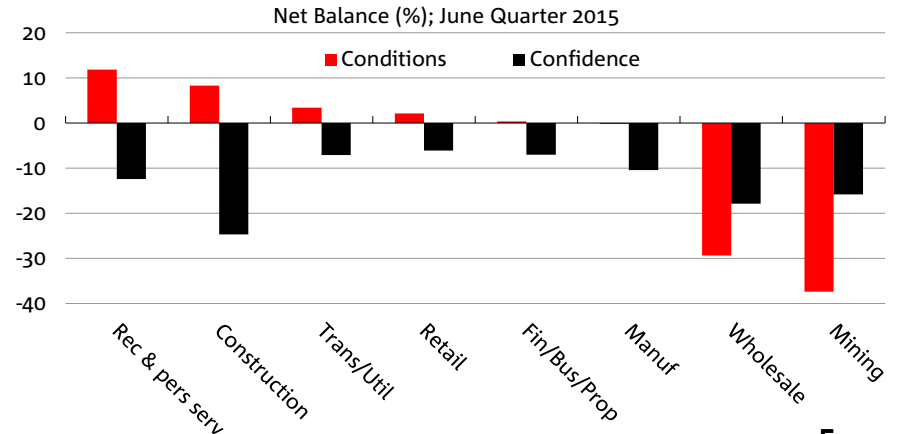


Chart 13: WA Business Conditions & Confidence by State





Non-residential construction activity soft and mining pipeline depleting

Weakness in resource investment has translated into softer non-residential construction activity more broadly (Chart 14). While there are some large projects still in the pipeline (private & public), the outlook is downbeat with the flow of new projects insufficient to offset a sharp decline in engineering construction – non-residential approvals have remained subdued.

Rising office vacancy rates (Chart 16) are consistent with very weak conditions in the office (and industrial) markets according to NAB Commercial Property Survey (Chart 17).

Chart 14: Non-residential Building Approvals (\$ millions)

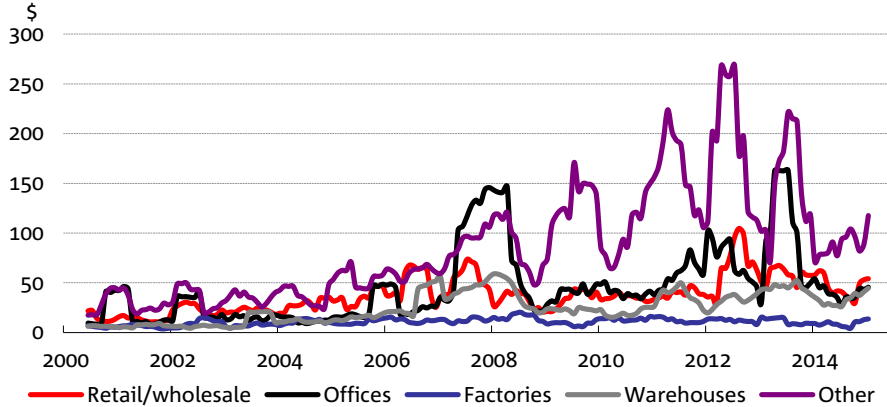
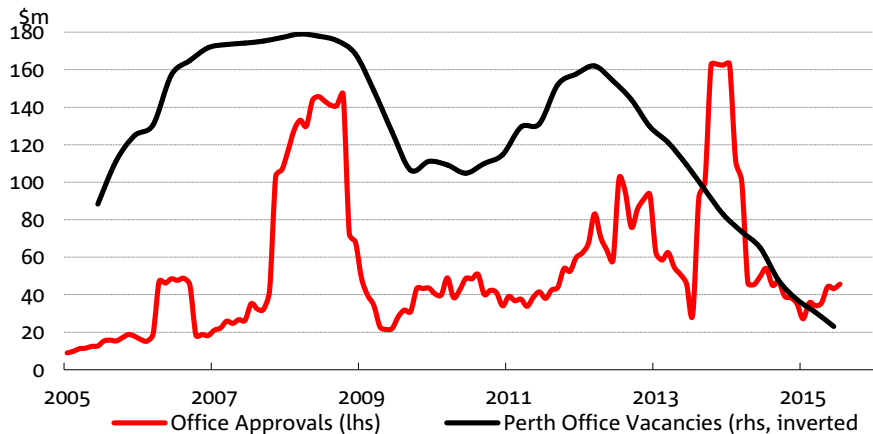


Chart 16: WA Office Market Conditions



Sources: ABS; JLL; NAB Economics

Expected capital expenditure (capex) by businesses (according to the ABS survey) suggest that mining investment in WA will continue to contract over the next 12 months (Chart 15), while NAB estimates of engineering work yet to be done (for heavy industry) suggests the drop in spending could be even more severe (slide 3).

Non-mining investment is considerably smaller and the ABS Survey provides no indication that a pick up is underway to help to offset declines in mining.

Chart 15: WA Capital Expenditure & Expectations

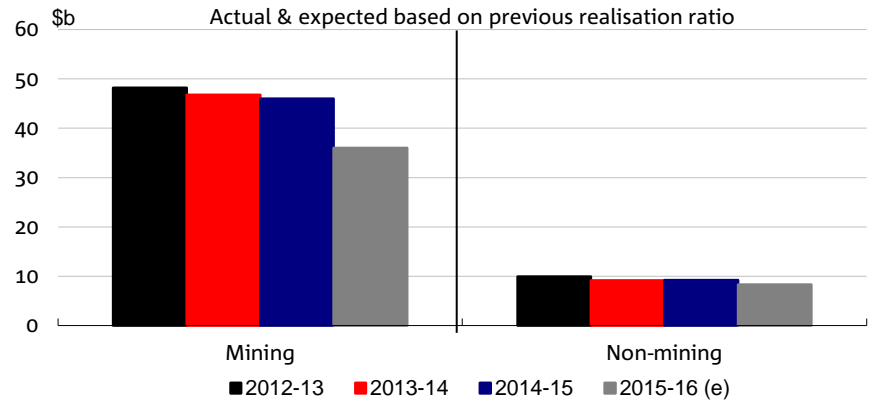
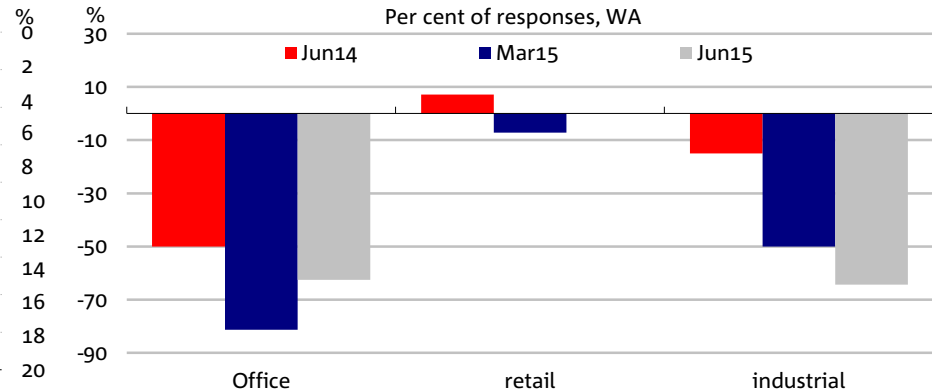


Chart 17: NAB Commercial Property Index - WA





Loss of mining sector (and related) jobs driving unemployment rate higher

Labour market conditions have deteriorated steadily across WA given the far reaching influence of the states mining industry. Despite having a more diverse industry mix, Perth does not appear to have fared much better than the regional areas (Chart 18)

Despite the headwinds, aggregate employment has continued to increase – 22k jobs created over the past year was insufficient to offset an increase in the labour force. Unemployment hit a more than 13-year high of 6.4% in July (eased to 6.1% in August).

Chart 18: Unemployment rate by region, %

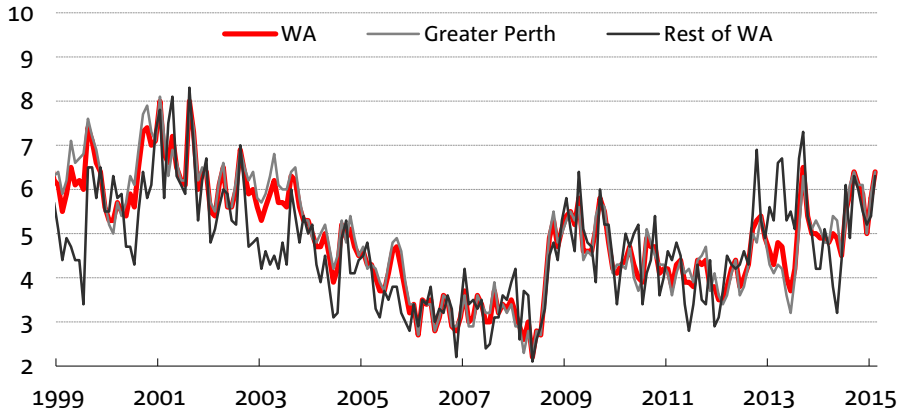
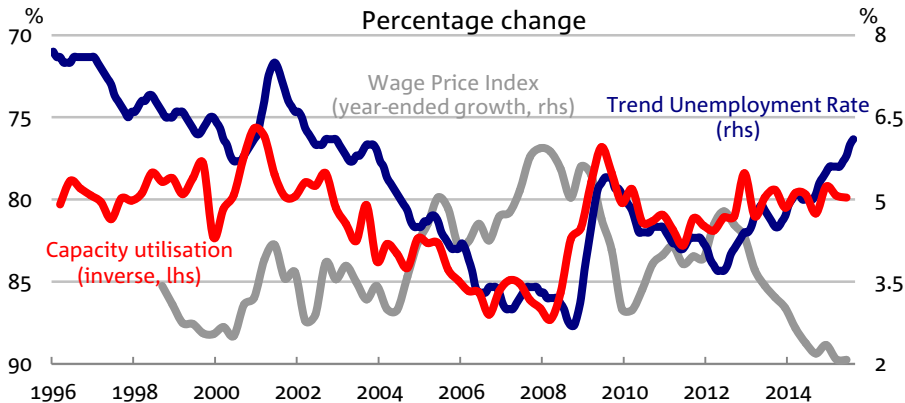


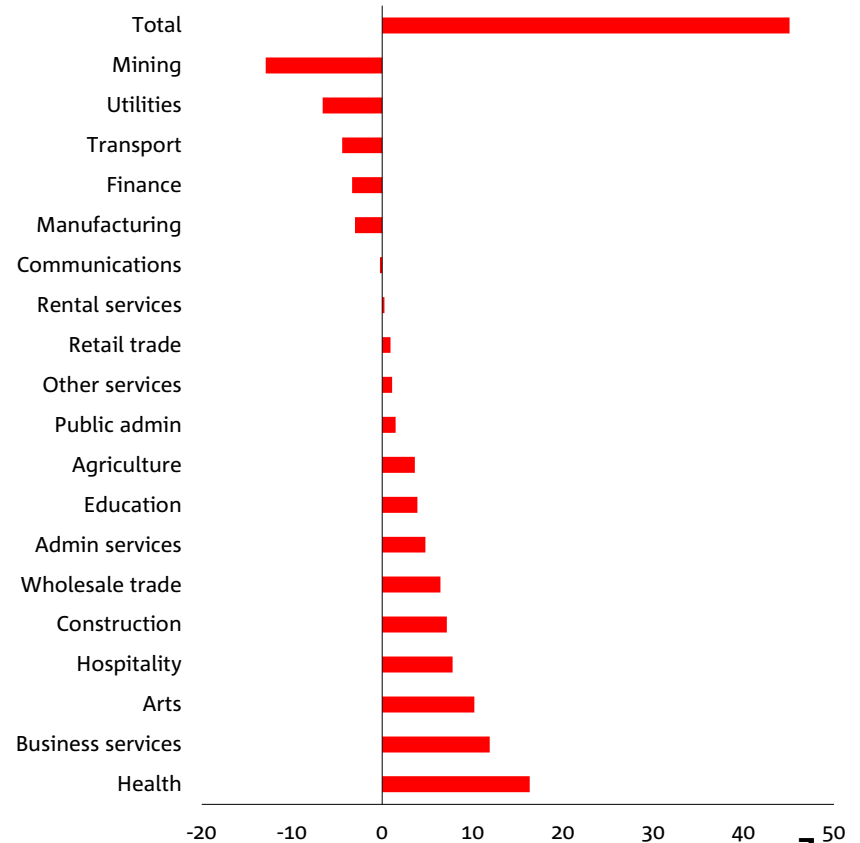
Chart 20: Unemployment rate, wage growth & NAB capacity utilisation rate



Sources: ABS; NAB Economics

In the last 12 months to June 2015, most of the jobs created were in health – consistent with stronger conditions in personal services according to the NAB Business Survey. Unsurprisingly, job losses have been largest in mining, consistent with the winding down of relatively labour intensive mining investments (Chart 19).

Chart 19: Change in employment by industry, last 12 months, WA, '000





Population boom unwinding as mining investment slows

Since peaking in 2012, WA population growth has slowed considerably. The slowdown has largely been driven by net overseas migration, although net interstate migration also ground to a halt. In contrast, natural population increases has continued to track higher (Chart 21).

After led the way for more than a decade, WA population growth is now more consistent with the national average (Chart 23).

Population trends are consistent with observations from the labour market. While job gains in WA have slowed from the levels seen in previous years, it appears as though it is mainly jobs held by foreign workers that have contracted. The fall in the number of employees born in New Zealand has been particularly pronounced. In contrast, employment of workers born in Australia has increased, although the majority of these jobs appear to be in part-time work (Chart 22).

Chart 21: WA Population growth (000s, over the year)

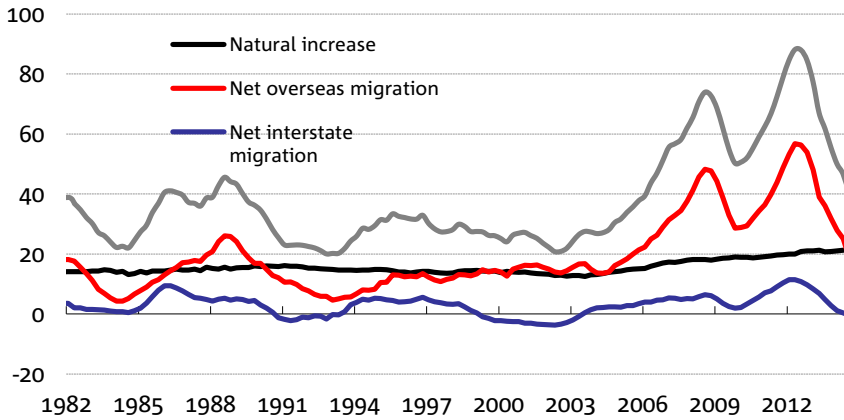


Chart 23: WA Population growth (year-ended growth)

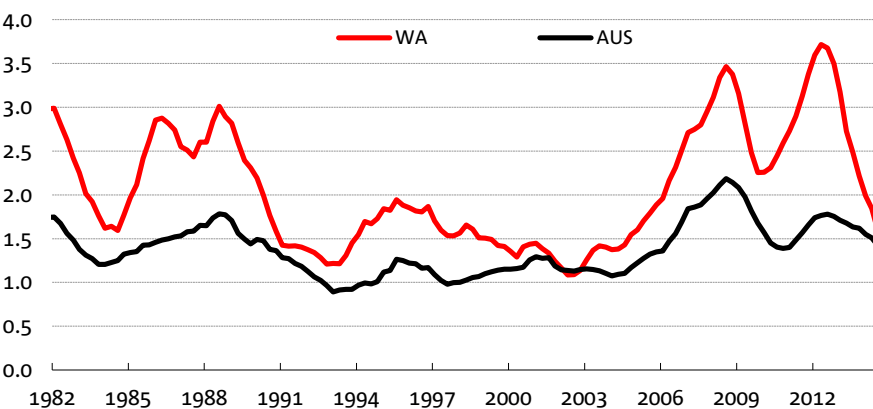
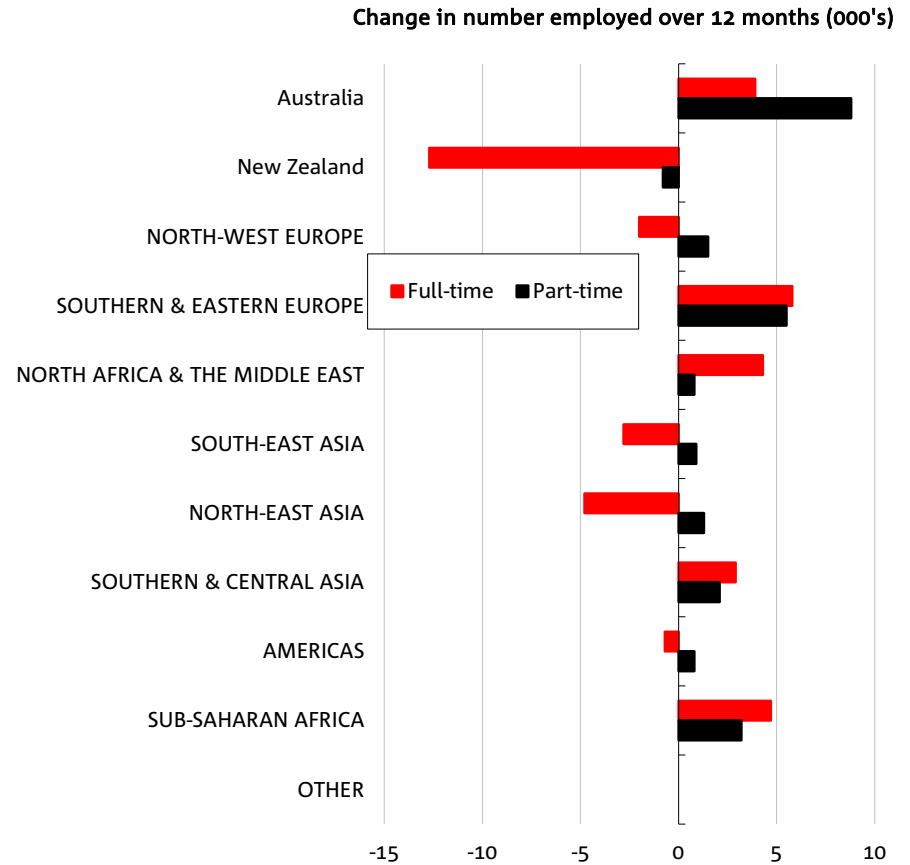


Chart 22: WA Employment by country of birth





Residential property prices hit by falling wages and slowing population growth

The slowdown in WA's mining sector – and the flow on effect to wages – is having an impact on residential markets. Property prices have generally been falling, with many mining regions experiencing dramatic declines. Building approvals and commencements are elevated, but have been trending lower since around the start of the year (Chart 24), suggesting less support for the local economy from dwelling construction in the near-term

The NAB Property Survey suggest sub-par price growth in the near-term (Chart 26).

Chart 24: WA Residential Approvals & Commencements

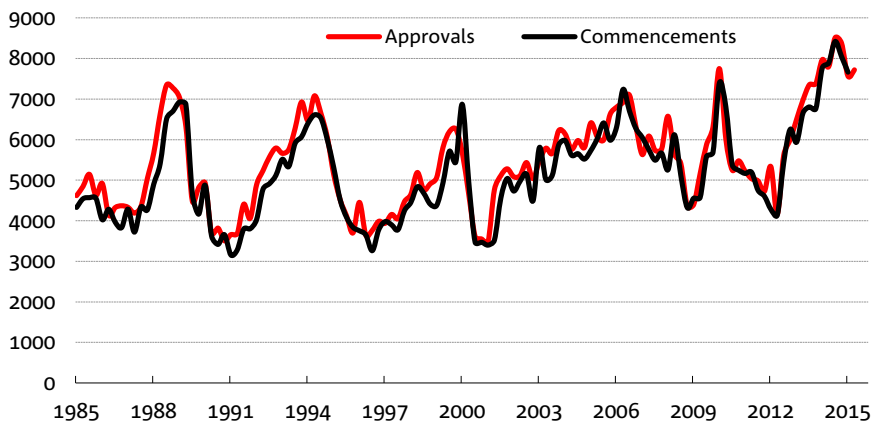
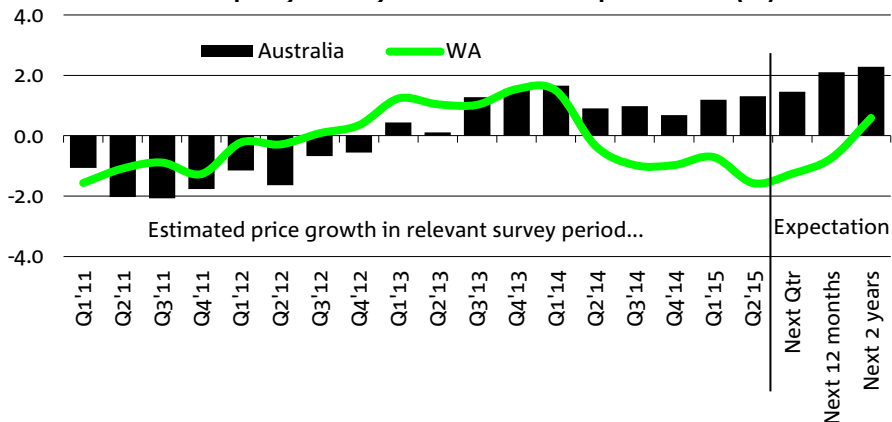


Chart 26: NAB Property Survey – House Price Expectations (%)



Weakening price are consistent across property types and regions (Chart 25). Price growth has been particularly weak for Perth units. While growth has not been quite as weak for regional houses, prices in regions such as the Pilbara have fallen significantly (see slide 3).

Residential property price growth by sub-region in Perth suggests fairly mixed capital growth for both houses and units across regions (Chart 27).

Chart 25: WA Residential Property Price Growth

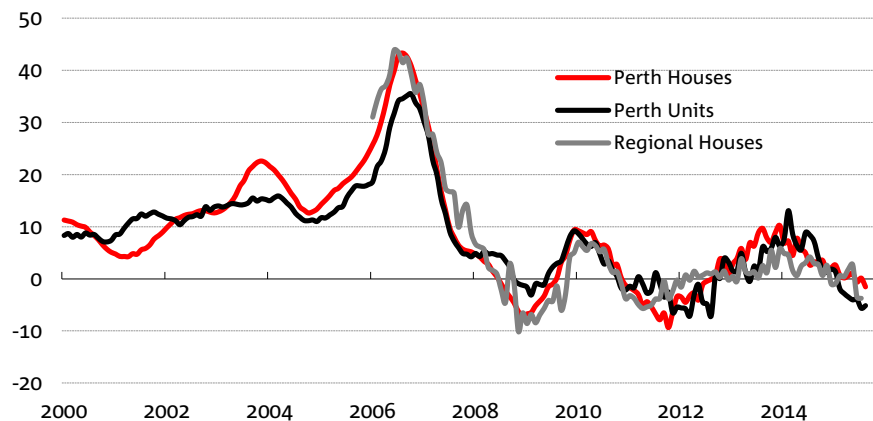
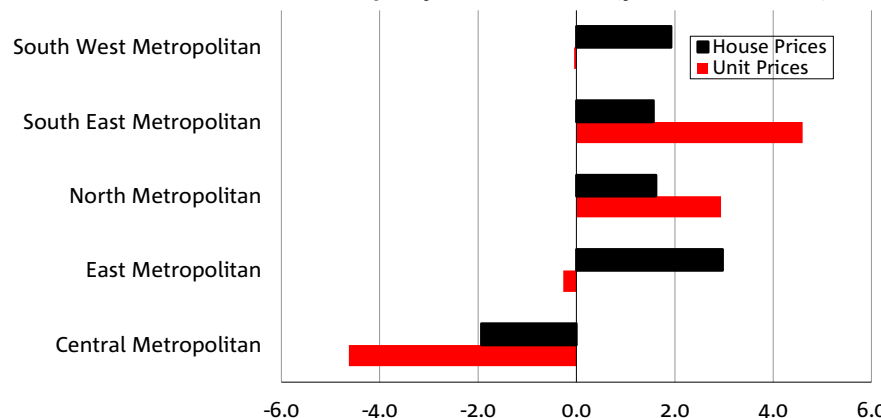


Chart 27: Perth - Median Property Price Growth (year to Q1 2015)





Budget surplus revised down on weaker economy and commodity prices

The State Budget for WA anticipates a deterioration in the operating surplus in the near-term and rising debt. The latest State Budget included new revenue and savings measures to help address fiscal deterioration (valued at over \$1.2b over 4 years). The projected operating balance in coming years are now significantly below estimates from the mid-year review (\$3.7 billion worse off over 3 years) (Chart 28).

The downward revision to the operating balance largely reflects lower expectations for revenue. A weaker than expected growth outlook and a significant deterioration in expected royalty income are the major drivers. The State Budget expects iron ore prices to lift from USD 47.5 per tonne in 2015-16 to around USD 50.7 per tonne in 2016-17. This is broadly consistent with NAB forecasts.

The WA government is projecting low expenses growth, reflecting public sector reforms and efficiency measures implemented over recent years. Expenses for 2014-15 are expected to come under mid-year projections by \$52 million, while expense growth is expected to slow to 2.5% in 2015-16 (from 4% in 2014-15), and will average less than 3% in the years to 2018-19.

To help support growth in the slowing economy, the State Budget included \$6.3 billion dollars of investment in infrastructure in 2015-16 and \$24.1 billion in investment over the next four years – although general government spending is easing back following the completion of hospital rebuilding programs.

Chart 28: WA net operating balance & royalty income (% of GSP)

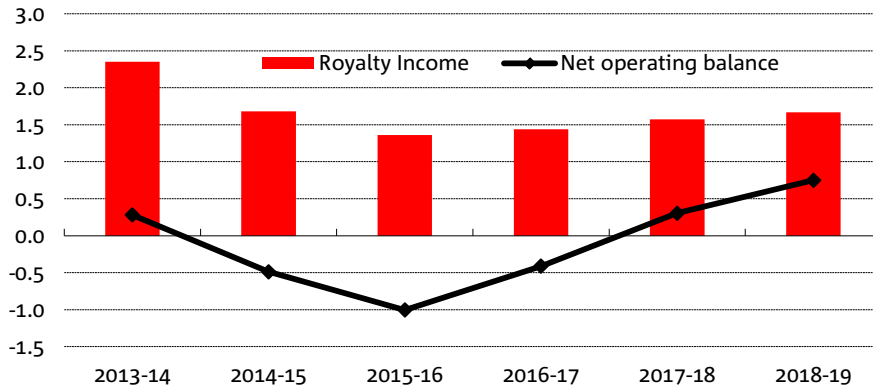
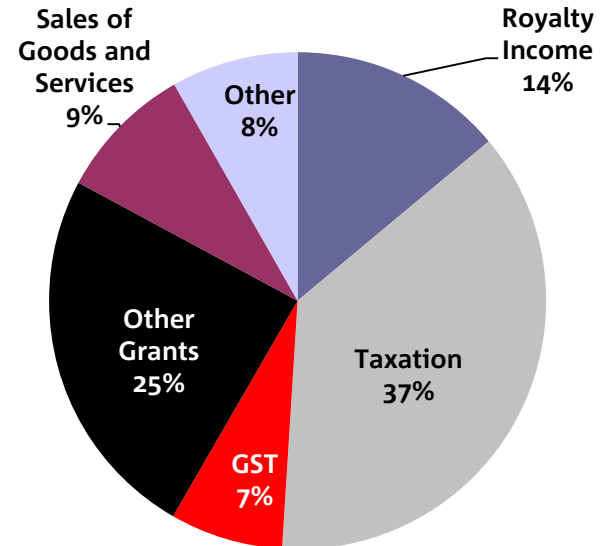


Chart 29: WA Composition of state revenues





Net debt rising, pressure on rating would come from sustained operating deficits

Given the decline in revenue growth and the Government's commitment to fund Asset Investment Program the states net debt is projected to rise over the forward estimates. Note, however that these estimates do not include anticipated proceeds from asset sales.

WATC borrowing programme for 2015-16 is estimated at AUD10.1bn of which AUD5.5bn is new lending and AUD4.6bn refinancing. New lending is estimated to decline over the forward estimates. Projections do not take into account proposed asset sales.

In July S&P affirmed WA's AA+ rating and changed the outlook from stable to negative. The outlook reflects view of one-in-three chance that the rating is lowered. Pressure seen to come from 'sustained operating deficits. Tax supported debt remains above 90% threshold.

The benchmark program will be the primary source of term funding, supplemented by floating rate notes. WATC will maintain around AUD1-2bn of commercial paper outstanding.

Chart 30: Western Australia Non-Financial Public Sector net debt

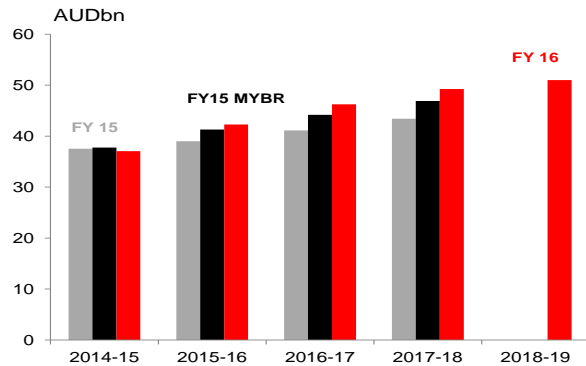


Chart 31: S&P credit metric: Tax supported debt

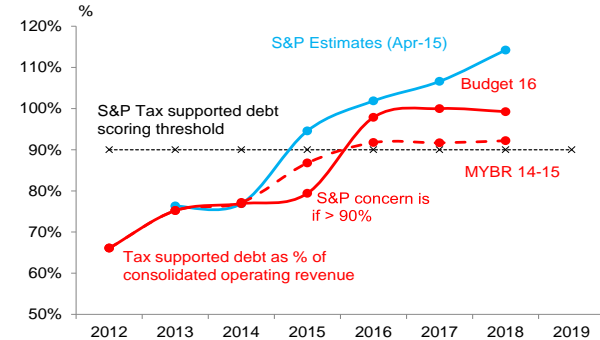


Chart 32: WATC borrowing programme

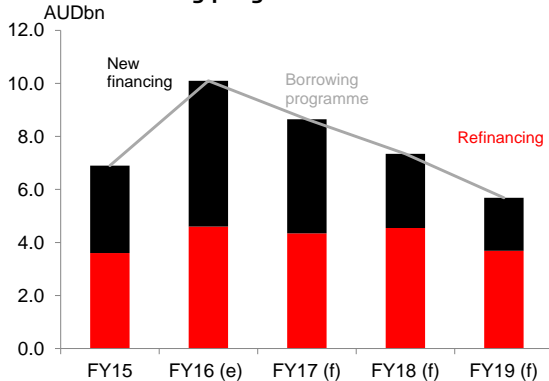
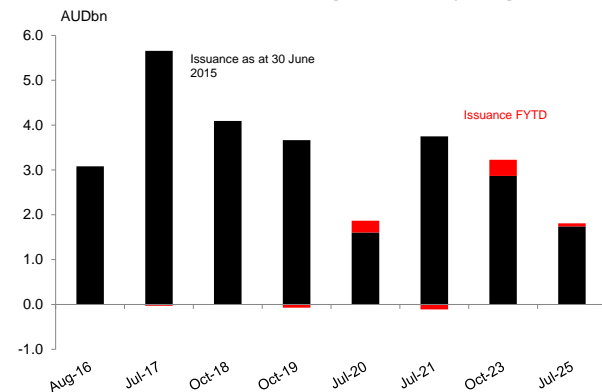


Chart 33: WATC term bonds outstanding as at early August 2015



Source: WATC, Western Australian budget papers, NAB



New mining operations driving export volumes up, but falling commodity prices hitting revenues

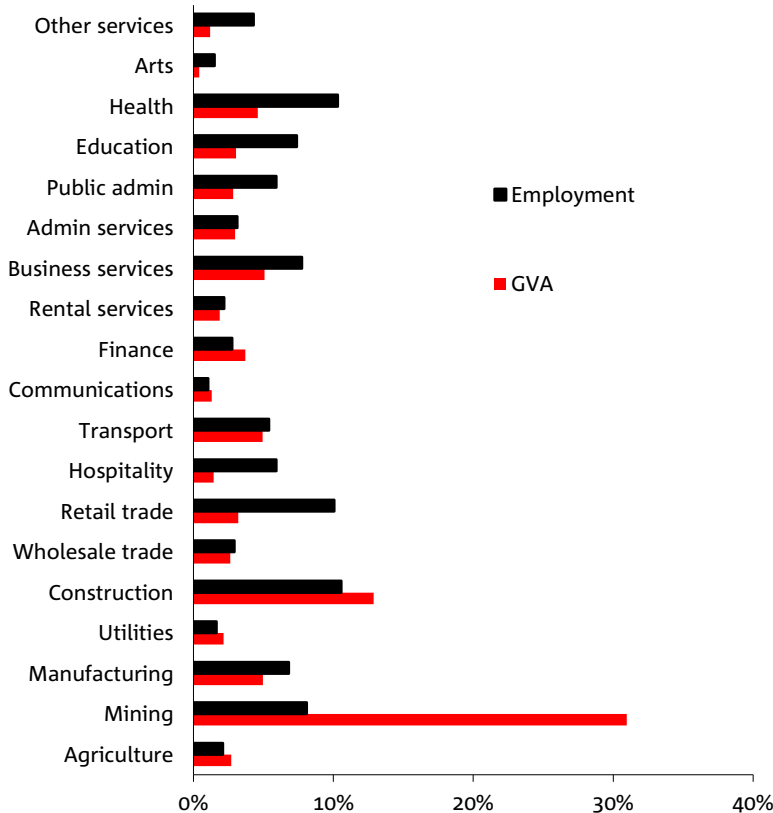
The industry share of the mining sector in WA has risen steadily since mid-2000s, reaching a historical-high of 31% 2013-14. That compares to less than 10% for mining Australia-wide. The once-in-a-generation mining boom has also driven growth in related industries including construction and manufacturing (through the downstream processing of minerals), bolstering construction's share of total economic output. In contrast, the composition of employment is much more diverse, reflecting the relatively higher labour intensity of other industries.

WA's export market is dominated by hard commodities. The completion of large LNG and iron ore expansion projects has helped to drive WA exports steadily higher, and is expected to continue to do so over the medium-term.

However, lower prices have more than offset rising volumes, contributing to a significant hit to local incomes and a drop in real net exports since mid last year (Chart 35). Iron ore and LNG prices are expected to be relatively stable, but a significant ramping up LNG exports is expected in 2016-17

As for rural commodities, ABARES recently reported better prospects for 2015-16 winter crop production due to better rainfall.

Chart 34: Composition of employment & GVA



Sources: ABS; NAB Economics

Chart 35: WA Net Exports (AUD billions)

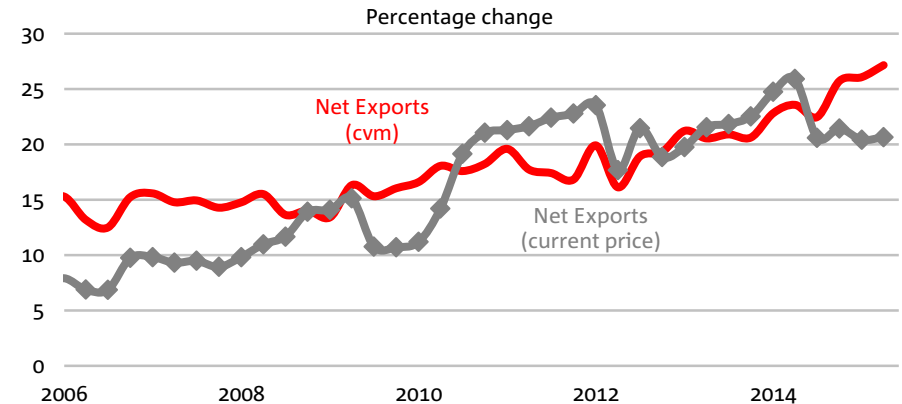


Chart 36: Top export destinations, WA, 12-month sum to July 2015

Value of exports (\$m)			Value of imports (\$m)		
1	China	55139	1	ASEAN	8511
2	Japan	20018	2	China	4896
3	ASEAN	11864	3	EU	4704
4	Korea	8327	4	Korea	3430
5	Singapore	5039	5	Singapore	3144
6	EU	2553	6	US	2890
7	India	1989	7	Japan	2060
8	Taiwan	1596	8	Germany	1225
9	US	1424	9	New Zealand	909
10	UK	991	10	UK	758
11	Germany	731	11	Taiwan	377
12	New Zealand	345	12	HK	64
13	HK	180			

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